

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 16832
[REDACTED]	)	
Petitioner.	)	DECISION
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On June 26, 2002, the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (the taxpayer), proposing additional income tax, penalty, and interest for tax years ending 12/31/97, 12/31/98, and 12/31/99 in the total amount of \$8,660.

On August 22, 2002 a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and held on March 25, 2003.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision affirming the Notice of Deficiency Determination. The issue is whether the unitary group, of which the taxpayer is the parent, includes a subsidiary that is referred to below as the Disputed Subsidiary.

**Facts**

The taxpayer is a distributor of supplies for maintenance, repair, and operations. It and its subsidiaries, other than the Disputed Subsidiary, are conceded to comprise a unitary group of corporations for Idaho purposes. The parent company operates in all states and has nexus in Idaho. The taxpayer sells to the commercial, industrial contractor, and institutional markets, through a large network of branch locations that are served by regional distribution centers. It sells about half of its merchandise through the branches, and ships the other half to customers by common carriers. It has a nationwide network of sales representatives. The parent company sells safety products as part of its very broad range of inventory.

The taxpayer acquired the Disputed Subsidiary in 1992. The Disputed Subsidiary's president at that time left the company in 1995 or 1996. The current president of the Disputed Subsidiary was a vice president as of 1992.

The Disputed Subsidiary engages in direct marketing of safety products to businesses. It has only one location, no sales representatives, and ships all of its products by common carriers. There were intercompany sales in both directions between the parent and the Disputed Subsidiary in the audit years, although they were very small as a percentage of combined sales of the unitary group.

The parent and the Disputed Subsidiary have some common directors. The Disputed Subsidiary had different officers from the parent in earlier years, but, in more recent years, the officers are the same. The top executives of the Disputed Subsidiary report to the parent. The parent provides internal audit, legal, tax, and treasury services to the Disputed Subsidiary but does not provide day-to-day services in accounting, accounts receivable and payable, marketing, printing of catalogs, purchasing, human resources, or advertising. Cash of the Disputed Subsidiary is swept daily and centrally invested along with the parent's cash. The parent and the Disputed Subsidiary do not share facilities.

### **Law and analysis**

Idaho Code § 63-3027(t) provides that two or more corporations may be considered a single corporation for income tax purposes, provided more than 50% of the voting stock of each of them is owned directly or indirectly by a common owner or owners, and such treatment is necessary to accurately reflect income. The Idaho Supreme Court has interpreted this statute to require combined reporting by a unitary business. *E.g., Albertson's, Inc. v. State, Dept. of Rev.*, 109 Idaho 810 (1984). The taxpayer does not dispute that the ownership requirement is satisfied here.

Unitary business is a concept of constitutional law under the Commerce and Due Process Clauses. A state may tax the multistate income of a nondomiciliary corporation if there is both a “minimal connection” between the interstate activities and the taxing state and a rational relationship between the income attributed to the taxing state and the in-state value of the corporate business. A state need not attempt to isolate the in-state income producing activities from the rest of the business. The state may tax an apportioned share of the multistate business if the business is unitary. But the state may not tax the business’s income that is “derived from unrelated business activity” or a “discrete business enterprise.” *Allied-Signal, Inc. v. Director, Div. of Tax.*, 504 U.S. 768, 772-773 (1992)(citations and internal quotation marks omitted); *Albertson’s, supra*, 106 Idaho at 815 n.4.

In 1965, Idaho adopted with slight modification the Uniform Division of Income for Tax Purposes Act (UDITPA), Idaho Code § 63-3027. The Act contains a formula for determining the portion of a corporation’s total income from a multistate business which is attributable to Idaho and therefore subject to Idaho’s income tax.

Combined reporting is a refinement of the apportionment principle. Its purpose is to permit application of the UDITPA apportionment formula to a single business enterprise that is conducted by means of separately incorporated entities. In an economic sense, such a business is no different from a similar business composed of a single corporation with several separate divisions. For tax reporting, such businesses should be treated the same. Combined reporting can be required only in the case of a unitary business. When the Tax Commission has found that a subsidiary is part of the taxpayer’s unitary business, then the taxpayer has the burden of proving that the finding is incorrect. *Albertson’s, supra*, 106 Idaho at 814-815. Here, the auditors have so found, and the taxpayer has the burden of disproving the finding.

Among the tests of unity is whether “the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state [; if it does], the operations are unitary.” *Edison Cal. Stores v. McColgan*, 30 Cal. 2d 472, 481, 183 P.2d 16, 21 (1947), *quoted at* 106 Idaho at 815. Here, the taxpayer parent, operating in Idaho, contributes a flow of goods in both directions and renders central services to the Disputed Subsidiary.

Another test asks “whether contributions to income result from functional integration, centralization of management, and economies of scale.” *F. W. Woolworth Co. v. Taxation & Rev. Dept.*, 458 U.S. 354, 364 (1982), *quoted at* 106 Idaho at 816. Here, the flow of goods shows functional integration. Management centralization is shown by the identity of officer slates and overlap of directors, as well as the reporting by the officers of the Disputed Subsidiary to the parent. The central services that exist, along with the cash sweep, show economies of scale.

IDAPA 35.01.01.340, as in effect in 1997, provides:

**340. SINGLE TRADE OR BUSINESS OF A CORPORATION OR AN AFFILIATED GROUP OF CORPORATIONS -- APPLICATION OF DEFINITIONS** (Rule 340). Section 63-3027, Idaho Code. (3-20-97)

01. Apportionment. All income of a trade or business shall be reported and apportioned even though only one (1), or less than all, of the corporation's business divisions or unitary group's affiliates operated in Idaho during the taxable year. The apportionment formula cannot be computed separately for each division, department, or affiliate of a single trade or business. (3-20-97)

02. Single Trade or Business. The determination of whether the activities of a corporation or an affiliated group constitute a single trade or business or more than one trade or business is based on the facts in each case. The activities of the corporation or affiliated group are considered a single business if evidence indicates that the segments being considered are integrated with, depend on, or contribute to each other and the operations of the corporation or affiliated group as a whole. The following factors indicate a single trade or business, and the presence of any of these factors creates a strong presumption that the activities of the corporation or affiliated group constitute a single trade or business: (3-20-97)

a. Same Type of Business. A corporation or affiliated group is generally engaged in a single trade or business if all its activities are in the same general line. For example, a taxpayer operating a chain of retail grocery stores is almost always engaged in a single trade or business. (3-20-97)

b. Steps in a Vertical Process. A corporation or affiliated group is almost always engaged in a single trade or business if its various divisions or affiliates are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer that explores for and mines copper ores and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independent of each other with only general supervision from the enterprise's executive offices. (3-20-97)

c. Strong Centralized Management. A corporation or affiliated group is considered one trade or business if there is a strong central management, coupled with the existence of centralized departments for functions such as financing, advertising, research, or purchasing. For example, a corporation or affiliated group is considered one trade or business if the central executive officers are normally involved in the operations of the divisions or affiliates and centralized offices perform the normal matters for the divisions or affiliates that a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing. (3-20-97)

03. More Than One Trade or Business. A taxpayer may have more than one trade or business. In this case the taxpayer shall determine the business income attributable to each separate trade or business. The income of each business is apportioned taking into consideration the instate and outstate factors that relate to that trade or business. (3-20-97)

Although the parent sells a wide range of equipment and supplies, it does sell safety equipment, some of which it obtains from the Disputed Subsidiary. The parent and the Disputed Subsidiary are in the same line of business, triggering the first of the three presumptions of the existence of a unitary business. Having found this, the Tax Commission does not need to address whether the second and/or third presumptions might be applicable.

### **Conclusion**

Accordingly, the Tax Commission finds that the taxpayer was engaged in a unitary business during the years in issue, and is therefore required to file a combined report that includes the Disputed Subsidiary.

WHEREFORE, the Notice of Deficiency Determination dated June 26, 2002, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest (computed through 09/30/03)(interest runs at \$.95 per day):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/97	\$2,038	\$804	\$2,842
12/98	1,523	484	2,007
12/99	3,406	829	<u>4,235</u>
		TOTAL DUE	<u>\$9,084</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

## CERTIFICATE OF SERVICE

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2003, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]

[Redacted]

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